Commercialization of Nonprofit Organizations: A New Model

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Introduction

Nonprofit organizations have historically derived some part of their revenue from earned revenue in addition to traditional sources. For example, universities have long charged tuition fees to cover at least part of their operating costs. However, the incidence of earned revenue becoming a nonprofit organization's primary source of income is occurring at an increasing rate. The future is likely to find the focus of nonprofit organizations shifting to earned revenue through the commercialization[1] of their organizations because of a number of social and economic factors.

Economists would agree that fifty years ago the primary source of nonprofit funding came from private charitable giving. Changes in government structure added public funding through grants and subsidies to nonprofit organizations' major funding sources. All the while, earned revenues have been supplemental sources of income, a practice that was commonly viewed as distasteful (Weisbrod 1997). Changes during the last thirty years in the distribution of private charitable giving, public funding and general preferences have increased the role of commercial activities in the nonprofit sector. Specifically, nonprofits are increasingly turning to earned revenue as their primary source of income as opposed to the traditional sources.

There are a number of current theories that attempt to explain the increased role of commercialization within the nonprofit sector. One school of thought suggests that the adoption of a business approach to nonprofit management leads to increased efficiency as well as financial stability. On the other hand, many argue that the commercialization of nonprofits produces only negative externalities, such as overdependence on fees leading

[1] Commercialization in this situation is defined as the propensity of nonprofit managers to rely less on donated sources of income and focus more heavily on fees for related services, and the sales of goods and services that are either related or unrelated to the organization's mission (Toepler 2006).

to mission displacement. If it is the case that nonprofit commercial enterprise displaces the nonprofit mission, one must wonder why nonprofits are currently pursuing commercial activities at all. As it is assumed nonprofits only act in the interest of the nonprofit mission, activities that detract from the mission must be less preferential to other activities. Nonprofit organizations' engagement in commercial activities signals a change in the way society views nonprofit involvement in commercial activities.

Nonprofit organizations' shift toward commercial enterprise may have a number of positive externalities that motivate the movement, as well. For example, nonprofit commercialization reduces dependence upon contribution funding, which minimizes the risk of mission drift due to financial pressures. The two perspectives may not be entirely at odds with one another. Instead, the theories' combined influences may have shifted the very core of nonprofits' objective function in regards to commercialization. The focus on the business-like environment along with the need to protect the mission of the nonprofit may lead to a reevaluation of commercialization.

Rather than speculate as to the actual degree of commercialization in the nonprofit sector or attempt to identify commercialization in the sector, this paper acknowledges commercialization as a present and growing facet of the nonprofit sector. Moreover, this paper will provide an economic explanation of the motivations that led to the shift in the nonprofit organizational structure. Factors that affect decisions to implement commercial activity in a nonprofit organization range from social forces to immediate economic benefits. The sum of the motivating factors provides a primary analysis of the causes of commercialization. In other words, when the social forces as well as the needs of the nonprofit are combined, a transformation in the way nonprofits view commercialization occurs. The result is a revised model that reflects the changes occurring in the sector.

I will begin by describing the literature that suggests and defines the growing trend toward commercialization. Following this description, I will explain the traditional nonprofit objective model. I will then offer an alternative model in response to the previously identified factors.

Literature Review

The cause and effect of the commercialization of nonprofit organizations is a volatile subject among foundations, philanthropists, and economists. There are many existing theories on the overall trend of nonprofits seeking commercial means of financing. The theories generally divide into two lines of argument. The first focuses on the nonprofit commercial endeavors' resemblance to business operations, and describes the development of social entrepreneurship. Accordingly, the social entrepreneurship literature stresses that the main purpose of nonprofit engagement in commercial activities is to achieve higher efficiency in its imitation of for-profit businesses. The second line of argument, generally concentrating on the financial needs of nonprofits, tends to note the perils of the shift and argues that commercialization is purely a reaction to a decline in funding. Existing literature offers some suggestions as to why nonprofits have chosen to pursue commercial funding.

The social entrepreneurship line of argument bases its theories in the claim that commercialization seeks only to increase the efficiency of supplying the output for which it received its tax-exempt status—its "nonprofit" output. This celebratory explanation posits that the adoption of commercial activities and organizational structure is a positive development (Bornstein 2004; Bradach 2004; Dees 1998; Toepler 2006). In such a rationalization, motivations for commercialization stem from competitive sources. As more for-profit organizations enter markets traditionally led by nonprofits, such as health-care, education, orphanages, and low-income housing, nonprofits feel pressured to mimic their for-profit competitors (Dees 1998; Weisbrod 1997). For example, competition in the field of higher education has led universities to subsidize their operations by commercializing their research (Dees 1998). Nonprofit organizations react to the new forms of direct competition by experimenting with commercial operations.

The social entrepreneurship group also identifies the pro-business zeal of the early 1990s, spurred by the dot-com craze, as a cause of the shift to a commercialized business structure. The business craze not only encourages nonprofit managers to engage in commercial activities, but increases social expectations of nonprofits to resemble for-profit operations. According to Bradach and Foster (2004), the nonprofit manager's reputation may be a factor in a shift to commercial output. Nonprofit managers who are generally viewed as passive bureaucrats desire to be viewed as active entrepreneurs that are a part of the capitalistic business environment.

On the other hand, the larger constituency blames the nonprofit industry's financial instability as the core cause of nonprofit organizations' adoption of commercial activities (Dees 1998; Lowell et. al. 2001; Toepler 2006; Weisbrod 1998). Generally, this view asserts that a decline of private and or public contributed revenues has forced nonprofit managers to seek alternative methods of funding in order to meet organizational needs (Toepler 2006). Dees (1998) also suggests that, at a minimum, nonprofit organizations are seeking a diversity of funding in order to provide a cushion for future funding variations.

Opinions vary on the actual source of the decline in contributed revenues. The most extensive literature suggests that the rise in commercial activities is the direct result of the reduction in public funding. In the arts especially, federal funding stagnated during the 1980s, during which time other forms of contributed income were not able to fully compensate for the loss (Toepler 2006). Schiff and Weisbrod specifically argue that nonprofit organizations “faced with declining support from government and unable to increase private giving significantly, appear to have increasingly turned to commercial activities traditionally performed by for-profit firms” (1991: 619). Another dimension of the same argument posits that an earlier increase in federal funding became an artificial stimulant to the growth of nonprofits and thus their expectations. In the end, when federal funding diminished nonprofits were unprepared to modify the structure of their organization to meet the narrowed source of funds (Toepler 2006).

Also, restrictions upon existing contributed gifts pose problems to the long-term financing of nonprofit organizations. Nonprofit organizations’ preferred source of contribution income is unrestricted donations—donations offered strictly by virtue of the nonprofit output without specificity as to the use of funds. However, there are three areas in which donations commonly seem to be restricted: grants, private giving and donor advised funds. The use of grants and donations are usually restricted to particular projects (Dees 1998). Donor-advised funds are a new development in the world of philanthropy designed to attract more donors by offering them increased control of their donations (Appelbaum 2002).

Stephanie Lowell, Les Silverman, and Lynn Taliento (2001) argue that donors' restricted donations are the "culprit" of nonprofit financial instability. When donors drive the budget through their restricted donations, there is an internal misallocation of funds. Organizations that seek funding for operational expenses and receive donations prescribed for special programs are no better off. Most donors give money designated for specific programs and thereby dismiss the nonprofit's needs for long-term investments that are required to build the organization. The result of this common pattern of donor giving limits nonprofit organizations' ability to grow. Lowell, et. al. (2001), are convinced that the solution is in combining the efforts of multiple nonprofits[2] as well as a change in psychology of donor giving, and they demand a revision of philanthropic giving patterns.

The actual funding prerogatives of foundations have changed in the last twenty years. Today, few foundations want to provide continual funding to nonprofits; instead, foundations attempt to motivate sustainable nonprofit practices by limiting the duration or applicability of funding (Dees 1998). Foundation support of donor-advised funds provides an additional source of restricted nonprofit funding. Donor-advised funds provide donors a greater amount of control in the distribution of their funds. Rather than donating to unrestricted foundation-supported causes, donors can utilize the lower transaction costs[3] of foundation funding while applying strings to their donations. Stuart Appelbaum and Bryan Clontz's (2002) interview with two foundations show that donor-advised funds account for two thirds of grant dollars awarded. Appelbaum and Clontz's

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[2] However, the joining of nonprofit resources tends to threaten for-profit organizations. As a result, many view resource sharing between nonprofit organizations as a violation of anti-trust laws (Cordes 1998).
[3] Foundations lower the transaction costs of donating money as economies of scale in research and nonprofit evaluation enable foundations to allocate funds efficiently (Kramer, 1999).

(2002) article suggests that more foundation donations will be restricted in the future as the popularity of donor-advised funds increases.

Additionally, according to Mark Kramer and Michael Porter (1999), the overall amount of foundation donations constitutes 5.5% of their assets each year, which is only slightly above the legal minimum of 5%. Kramer and Porter (1999) suggest that foundations are not an efficient means of allotting funds to nonprofits as they currently operate even despite the reduction in transaction costs they provide. Moreover, foundations that accept individual donations[4] mute the immediate social benefit of charitable contributions. A $100 donation delivered through a foundation actually only donates $5.50 per year. While a foundation will continue to donate for many years, after ten years the total donation is still only $55.00, while the foundation receives tax benefits on the appreciation of their assets. Thus, Kramer and Porter (1999) conclude that foundations, unless they discover ways to create more value in themselves, are inefficient vehicles in which to contribute funds to nonprofit organizations.

Normally, scholars view the financial motivation along with a tendency for the nonprofit organization to suffer mission drift (Bradach 2005; Cordes 1998; Dees 1998; Frumkin 2002). Such fears argue that the desire to find alternative methods of funding will drive the course of the nonprofit, rather than the nonprofit output. The situation is often referred to as “the tail wagging the dog” (Dees 1998). The aversion generated by such a situation would have additional repercussions such as a decrease in donor contributions (Schiff, 1991).

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[4] There are different forms of foundations; here Kramer and Porter refer to foundations that receive individual donations as opposed to family or corporate foundations, which are generally endowed by a single source.

Cordes and Weisbrod (1998) recognize that nonprofit commercial enterprises have the opportunity to supply both federal and local government tax revenue losses. The government gives nonprofits a subsidy in the form of exemption from federal and local income taxes in order to encourage the production of their nonprofit output. When nonprofits engage in commercial activity that is not related to their nonprofit output, they are subject to a federal unrelated business income tax (UBIT), which many local governments are adopting as well. However, Schiff and Weisbrod (1991) conclude that many nonprofits avoid the UBIT through a method known as cost-shifting. Cost-shifting transfers the joint costs of production, costs that apply to both the commercial and nonprofit output to the commercial output in order to report lower net profit from commercial activities.

However, the ability of nonprofits to shift their costs is a signal of other consequences of commercialization. Schiff and Weisbrod (1991) suggest that nonprofits that are able to produce commercial output with some of the same resources that produce the nonprofit output are subject to economies of scope. Economies of scope enable nonprofits to produce commercial products without significant additional cost as their nonprofit output utilizes many of the same resources. For example, nonprofits whose nonprofit and commercial output use the same administrative staff cut costs of production.

Commercialization of nonprofit organizations is not a possibility of the distant future; it is here, now, and booming. In the fiscal year 1999, the IRS captured $665.9 million in taxes from nonprofit groups, which is a 40% increase from the previous year. In 2001, the Metropolitan Museum of Art’s commercial endeavors alone produced $96.6

million in revenues. Conversely, the Met paid roughly $1.5 million in taxes (Strom 2002). By one estimate, the nation's nonprofit organizations' commercial activities make more than $60 billion a year.

The diversity of theories may reflect the diversity of nonprofit motivations. Bradach and Foster (2005) report statistics of nonprofit organizations individual motivations for entering commercial activities. Of the organizations questioned, 32% attributed their actions predominantly for mission reasons; 58% cited a combination of mission objective as well as financial reasons. The remaining 10% reported purely financial motivations. The findings suggest that nonprofit involvement in commercial activities is not the result of a single factor.

The Old Model

Previous economists have utilized a model that hypothesizes nonprofit manager's disutility from commercial activities. Under the assumption that nonprofit managers receive a greater benefit from activities that produce the nonprofit output, activities that possibly detract from the nonprofit output provide less utility to the nonprofit manager. As many once viewed commercial activities as a threat to the mission of the nonprofit as well as an inhibitor of the amount of contributed funds, analysts concluded that commercial activities provide less utility to the nonprofit manager.

While nonprofit production models are based on the preferences of the nonprofit manager, for-profit production models predict that they always attempt to maximize profits from their commercial activities. Schiff and Weisbrod (1991) reevaluate the traditional profit maximizing model to allow for nonprofit manager's disutility of commercial activity. Their model focuses on the managerial choice between producing two outputs, the nonprofit, z, and the commercial, x. Commercial outputs are sold at an exogenous market price, p, and nonprofit output is financed by donations, D, and perhaps by profits from commercial activity. Revenues can also be spent in solicitation of additional funds, S. The production of the nonprofit and commercial outputs requires resources of a certain cost, C. The model assumes that nonprofit managers receive utility from nonprofit output and disutility from commercial output. Schiff and Weisbrod (1991) maximize the objective function subject to the non-distribution constraint, in which the nonprofit organization must break even. The function is written as:

$$\text{Maximize } U(z,x) \text{ subject to}$$
$$D(z, x, S) + px - C(z, x) - S = 0$$

where U represents the total utility a given combination of commercial and nonprofit output can create. The production of nonprofit and commercial output has its limits. Each product earns a certain revenue and also a certain cost. Because of the non-distribution constraint of nonprofits, the total revenue must equal total expenses. The costs of producing the nonprofit and commercial output (S and C[z,x]) must be equal to the revenue they create (D[z,x] and px).

Schiff and Weisbrod (1991) conclude that a nonprofit organization will maximize utility by producing nonprofit output further than the profit-maximizing level, to the point at which $Dz + Uz/\lambda = Cz$ where λ is the marginal utility of income. The production of the nonprofit output creates benefits in its application to the nonprofit mission as well as the contributed funds it generates—nonprofit output creates positive utility. Nonprofit managers will thus choose to produce the nonprofit output above the point where the cost of production is offset by related revenues because of the preference nonprofit managers have for the nonprofit output. On the other hand, the organization will take less than full advantage of the commercial opportunities due to its negative utility (in consideration of manager's preferences and its affect on donor contributions). Therefore, Schiff and Weisbrod (1991) determine that the nonprofit organization will produce commercial output to the point at which $p + Dx + Ux = Cx$ using profits earned to cross-subsidize exempt activity. In other words, nonprofits will produce commercial output only to the point where the profits exactly offset the perceived negative impact that commercial enterprise has on the mission of the nonprofit.

Additionally, Schiff and Weisbrod (1991) find that changes in donations will influence the extent of commercial activity. A fall in donations is comparable to an inward shift of the manager's budget constraint, which thereby motivates less preferred sources of income. The underlying consideration maintains that nonprofits production mix is determined by managerial preferences rather than profit maximization, and commercial output provides negative utility.

Many have commented on the financial limits and dependency nonprofits have upon charitable contributions and the consequences of nonprofit commercialization, but few have addressed the two together. This paper argues that the two should be presented together because they are directly related. I propose to fill the gap in economic literature on the causes and consequences of the commercialization of nonprofits.

Theory

There are a number of reasons why commercialization of nonprofits has flourished within the last twenty years, and they are not entirely exclusive. Changes in societal norms, public funding, and private donations have had a collective affect on the future path of nonprofit organizations. These changes require a revision of previous nonprofit objective models as the societal changes have effectively revised the norms of nonprofit operations.

Schiff and Weisbrod's (1991) model established nonprofit organizations' aversion toward commercial activity. Current statistics regarding the growth of commercialization suggest that nonprofits are no longer avidly shunning engagement in commercial activities. Instead, the model must be revised to accurately reflect the condition of current nonprofit activities.

The old model suggests that commercial activities of nonprofit organizations negatively influence donations. Yet current trends within foundation funding and private donations prove otherwise. Foundation and private donors' tendency to support nonprofits that signal self-sufficiency through commercial activities implies a reversal of the relationship Schiff and Weisbrod (1991) initially proposed. Nonprofit organizations that do not provide a commercial output lack sufficient ability to signal their impact on the community. A museum has a higher ability to record attendance levels and thus its nonprofit output when it charges admission fees. Commercial activities signal a nonprofit's ability to independently provide goods to the public, which in turn is a signal of their value in the community. Potential donors have the ability to observe the community's appreciation for the organization through its support of the commercial activities. The nonprofit output, on the other hand, may be funded in a large portion by a small number of people.

Additionally, the business-like environment commercialized nonprofits present suggests increased efficiency. Increased efficiency attracts donors as it assures them that a greater percentage of their donation directly applies to the nonprofit product rather than administrative needs. Nonprofits that are not forced to cut the bottom line may operate with excessively high overhead costs that deduct from the impact of donations on the nonprofit output. A shift toward commercialization increases donation revenue as it signals independence as well as efficiency.

The conclusion of the model emphasizes that output decisions are the choice of the nonprofit manager. The nonprofit manager may receive utility from a new reputation. The social appreciation of business enterprises across the globe also extends to nonprofit organizations. A shift toward commercial output thus increases the reputation of the nonprofit as a whole and also the nonprofit manager's personal reputation. Commercial output changes the position of the manager from a passive receptor of donations to an esteemed entrepreneur within the industry. The motivation of the manager to pursue commercial activities for the increased reputation of the nonprofit and his position will shift the objective function to favor commercialization as offering positive utility rather than negative utility.

Also, the current model suggests that commercial output is detrimental to the core mission of the nonprofit. Individuals feared that the desire to maximize profits went hand in hand with dislocating the mission of the nonprofit. However, as commercial revenues are often used to cross-subsidize the nonprofit output, they are actually directly benefiting the mission of the nonprofit. For nonprofits who are dedicated to their mission of maximizing the quantitative output of their nonprofit good, commercial activities provide tangential benefit. For example, museums that provide parking, restaurants and gift shops are more likely to attract visitors. Individuals may enter purely for the auxiliary services the museum provides and stay to enjoy the exhibits. In this case the direct result of the commercial activity is the furtherance of the mission itself.

Schiff and Weisbrod (1991) fail to recognize the disutility provided by soliciting for funds. Their motivations for assigning disutility to commercialization are mirrored by the effects of excessive solicitation. Soliciting for money is expensive as it requires large amounts of labor, much of which is skilled labor specialized in writing grant applications. Additionally, solicitation of funds can lead to situations in which the "tail wags the dog." Not only could the nonprofit exert too much of its resources in the objective of gaining donated funds, but at some point the utility of the funds becomes negative.

The restrictions on funds that nonprofits may solicit can also lead to increased expenses without gaining any utility that enhances the attainment of mission. As earlier noted, grants generally apply to restricted purposes or programs. Nonprofits may choose to create additional programs to qualify for said grant; the net contribution in some cases amounts to a budget deficit. Donor restrictions on private contributions potentially follow the same lines. Solicitation for funds can be as perilous as many once viewed commercialization.

Not to mention the additional facet that too much solicitation may disengage potential donors. Solicitation costs money. For donors who view the expenses of solicitation as greater than their potential donation the act of soliciting is a waste of resources. Donations that essentially fund only more solicitation have a zero net impact on the nonprofit output. Donors are hesitant to donate to nonprofits that appear to have inefficient or excessive levels of solicitation. Nonprofit organizations' shift to commercialization and the resulting efficiencies of production protect nonprofits from being viewed as having too much solicitation.

It is important to note that the cost of entering commercial activities may be less than Schiff and Weisbrod (1991) initially anticipated. The realization of cost-shifting also implies the presence of economies of scope. Economies of scope require expense sharing between the nonprofit and commercial output. Economies of scope are more likely to be present in situations where the commercial output is closely related to the nonprofit output. Museum admission fees and parking are examples of situations in which economies of scope are present. The nonprofit output of museums encompasses a number of expenses, such as the acquisition of art and facility expenses, of which commercial activities can take advantage. A gift shop inside a museum shares the overhead of facility maintenance, utilities, administration, and perhaps donated labor, whereas a for-profit gift shop covers its overhead solely from the commercial enterprise. The sharing of expenses provides a cost advantage to commercial ventures in the nonprofit sector that is absent in the for-profit sector.

The changes in societal norms, donor expectations and financial structures alter the format of Schiff and Weisbrod's (1991) previous model. While nonprofit managers still execute output decisions based on preferences rather than profit-maximization, the preferences themselves have shifted. The shift in preference relationships affects the format of the model, and explains the increases in nonprofit commercialization.

Results

The abovementioned revisions to the assumptions of the nonprofit's objective function necessitate a revision of the function itself. To summarize, commercial activity is beneficial to the overall objective of the nonprofit, and thus the commercial output must have a utility that is greater than zero, $Ux > 0$. Donors are attracted to nonprofits that are self-sustainable, which changes the previously negative relationship between donations and commercial activities to a positive one, $Dx > 0$. Solicitation expenses are higher than originally believed due to the prevalence of restricted donations, whether private, public or through foundations, an increase in the cost of S. The cost of commercial output, on the other hand, is less than originally believed because of nonprofits ability to share expenses across their commercial and nonprofit output. The cost of producing the commercial output is supplemented by the benefits of cost sharing, Cx-Cs.

Nonprofit output in the new model is subject to an additional restraint which highlights the negative effect of excessive solicitation and restricted donations. The additional clause subtracts the donations that are due to blind solicitation and do not benefit the nonprofit. Because there is a point where solicitations do not benefit the nonprofit output, but detract from it, excess solicitation has a cost that must be deducted as such within the objective function. The total amount of donations remains the same, but donations that do not benefit the nonprofit output—the result of excessive solicitation—are subtracted from the equation as an additional cost, D(*e*).

$$D(z, x, S) + px - C(z, x) - S - D(e) = 0$$

The changes in the objective function also alter the preferential production amounts of the nonprofit and commercial output. As a result of the changes in the relationships between commercial activity and donations as well as the overall nonprofit mission, quantity produced will also change. The equation for the nonprofit output remains the same, yet the amount of commercial output changes due to the transformations in the assumed relationships. Nonprofits will still produce the nonprofit output to a point beyond the profit maximizing amount. Moreover, this point is further in the preference direction as the nonprofit has additional funds produced by the commercial enterprise at its services.

The nonprofit manager will choose to produce the commercial output at a point above the profit maximizing level, as well. The adjusted equation for the commercial output is

$$p + D + U(m, r, f)/\lambda = Cx - cs$$

when profits are used to cross-subsidize the nonprofit output. Commercial output has a positive relationship with donations, D. As commercial activities increase, the nonprofit receives more donations. The utility of commercial activities is also positive. Utility is a factor of the increase in mission via attendance, reputation and efficiency. Like the nonprofit output, the utility of the commercial output is dependent upon the marginal utility of income. Commercial activity is only as useful as each additional dollar earned. Finally, the cost of producing the commercial output is subsidized by the ability to share costs with the nonprofit output. Therefore, the nonprofit will engage in commercial activities to the point where the cost of producing the commercial good, minus the costs that are shared with the nonprofit output, are equal to the market price, the donations and utility derived from the sale of the goods. The utility generated by the commercial output suggests that the nonprofit manager will produce more than the profit maximizing amount because the costs of doing so are offset by positive externalities.

This model assumes that there are positive interior and exterior benefits of a nonprofit that provides commercial output. As a result, the nonprofit manager will increase the commercial output to a degree that is directly related to the increase in utility that commercial output provides. Nonprofits thus engage in commercial activities as a reaction to the increased utility of commercial activities themselves. The Alaska Raptor Center[5] has an extensive gift shop that offers guests the opportunity to experience "guilt-free" shopping. The allure of the gift shop and its unique gifts, such as shirts that use the bald eagle to poke fun at bald individuals, entice more visitors than would otherwise be the case. The increase in attendance motivates the Alaska Raptor Center to maintain the gift shop and offer an amount of services above the profit maximizing level. The external benefits of the commercial activity counteract the additional cost of its production.

Additionally, shifts in output may be the result of a reduction in donor contributions which makes commercial output even more attractive. However, it is important to note that most nonprofits would engage in commercial output regardless of an overall decline in donated revenue.

As the economies of scope assumption is dependent on the commercial output's ability to share expenses with the nonprofit output, the above model best fits nonprofit environments in which commercial activities closely relate to the nonprofit output. Situations in which this is most prominently evident today are in the service nonprofits,

[5] Reference to Alaska Raptor Center is from personal experience.

such as the arts, medical care and education. Universities utilize the expenses of graduate researchers and professor salaries in the production of research that is sold commercially to corporations. Nonprofit hospitals share the costs of the facility and employees by conducting research or by renting medical offices to for-profit professionals.

Conclusion

Nonprofits have long been an accepted and valued segment of the national economy. The nonprofit sector provides more than 15% of total employment and constitutes a significant part of the gross domestic product in the United States. Nonprofits have funded their operations through contribution revenue, the dominant method, as well as earned income. A new aspect within this industry is the increasing use of commercial activities to generate funds. The change in funding patterns signifies a number of social shifts that have enabled the growth in the commercialization of nonprofit organizations.

I identified a number of factors that have revolutionized the way nonprofits evaluate pursuing commercial enterprises. The causes range from reductions in government funding to increasing donor restrictions to social trends. The sum of the factors generates a reversal of previous aversions to commercial activities in the nonprofit world. The revision of attitudes towards commercialization also revises the objective function of nonprofit organizations. Whereas the previous model assumed that nonprofit managers viewed commercial activities as a threat to the mission and other sources of income, the new model suggests the reverse to be true. When the effects are translated through the objective function, it is evident that nonprofits will seek a larger portion of their revenue through commercial sources. The number of nonprofits involved in commercial activities is thus bound to increase.

The revision of the traditional model reverses contemporary views of nonprofit involvement in commercialization. One may wonder why more nonprofits do not engage in commercial activities. This realization suggests that there are additional negative externalities to commercialization that have not previously been addressed. Nonprofit managers may be hesitant to engage in commercial activities in light of tighter federal and local government restrictions on unrelated business income tax. If a nonprofit were to engage in commercial activities reporting minimal revenues through cost-shifting, they may be suspected of fraudulent reporting. Nonprofits that use cost-shifting may be forced to pay corporate income tax on all commercial revenue as well a local property taxes on land used for commercial purposes. Commercialization poses an increased risk for an audit, and may cause nonprofit managers to shy away.

Also, some nonprofits may have longstanding relationships with the government that entering into commercial activities would jeopardize. As nonprofits expand, particularly into commercial activities, governments lose money. Every dollar that nonprofits earn (not subject to UBIT) is another dollar the US government cannot tax. The nonprofits' dependence on the government's good will may lead to shunning commercial activities, which pose a threat to their government counterpart. It is possible to have many other specific situations in which dependency upon certain forms of funding may be challenged by too many commercial activities. Additional externalities which would prevent nonprofits from commercializing deserve extended research, but are not the subject of this paper.

Instead, this paper suggests that the cause of commercialization is not solely the result of limited funding or social entrepreneurship, but a combination of both, and that this that has revolutionized the way nonprofits view commercialization in its entirety. The effect of such findings is dramatic as it predicts the increased growth of commercial activities in the nonprofit sector. As a result, it would stand to reason that there will be a number of policy changes to adjust for the increased proportion of nonprofit revenue that stems from commercial resources. Nonetheless, commercialization in the nonprofit sector is a reality and it is a rapidly growing trend.

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